LEGAL FEE BILL AUDIT ISSUES WARRANT ATTENTION

The Corporation continues to engage outside counsel to provide legal services. Carryover RTC-related legal work has also added to the volume of law firms performing work on behalf of FDIC. Although not as extensive an effort as has been the case in the past, current estimates are that the Corporation has active contracts with law firms to handle 7,808 legal matters. Fees associated with these contracts total nearly $16 million for the 3 months ending March 31, 1997. These firms are providing a wide range of services for the Corporation and like any major contracting endeavor, the area of contracted legal services poses risks. To address these risks, the OIG has conducted numerous audits to ensure that legal services rendered and charges billed are fair and reasonable, adequately supported, and within the terms of applicable guidelines and agreements. While these audits are similar to other audits of contractor billings, they are, by their nature somewhat unique.

COURT UPHOLDS ENFORCEMENT OF OIG ADMINISTRATIVE SUBPOENA

The United States District Court for the District of Columbia granted the OIG's petition to enforce the Inspector General's administrative subpoena *duces teum* issued in connection with a law firm that provided services to RTC and FDIC. The subpoena sought information on the identities of certain clients of the firm, and was opposed on a number of grounds, including that the termination of the RTC nullified the outstanding subpoena, that the Inspector General lacked statutory authority to conduct the audit, and that state bar rules precluded disclosure of the information we sought. The Court ruled that the merger of the RTC and FDIC did not terminate the outstanding subpoena of the RTC OIG. Further, the Court determined that in federal subpoena enforcement proceedings, federal and not state law governs, and that information seeking client identities and matters involving the receipt of legal fees are not ordinarily privileged.

Under a memorandum of understanding, RTC and FDIC's Offices of Inspector General have performed audits of law firms providing legal services to RTC and FDIC. Generally, RTC OIG had audit cognizance of law firms with over 50 percent of their legal fees paid for services rendered to RTC. The converse was true with respect to legal fees paid for services to FDIC. Over the past year, our audit efforts have been consolidated so that more and more, results of RTC and FDIC related work are communicated jointly.

During the current reporting period the OIG issued 29 reports on audits of legal fees paid to various firms. These audits identified questioned costs of over $1 million. Additionally, during the reporting period, the OIG brought several important matters relating to these legal fee bill audits to the attention of the Audit Committee at its monthly meetings.

AUDIT COMMITTEE PROVIDES FORUM FOR RESOLVING SIGNIFICANT ISSUES

The first matter that we referred to the Audit Committee, and which we reported in our last Semiannual Report as a significant management decision with which we disagreed, related to the Legal Division's use of the sliding scale to determine disallowances. We discussed this issue with the Audit Committee in connection with our audit of legal fees paid to the law firm of Haley, Sinagra & Perez, PA. In that audit the OIG questioned $127,821 of the firm's billings to FDIC for fees and expenses. Of this amount, $119,456 represented hours charged that were not supported by time sheets. The Legal Division responded that although the charges were appropriately questioned, it would not disallow them in their entirety, deciding instead to apply a "sliding scale" methodology that resulted in disallowing $11,946 or 10 percent of the total. The OIG disagreed with that decision. We view the sliding scale approach, which the Legal Division applies at the management decision stage, as an arbitrary and highly subjective method for determining disallowances and one that we cannot test or endorse as the best approach for determining disallowances. In effect, the Legal Division is prematurely giving up its right to seek recoveries from law firms who cannot supply required documentation to support their billings.

At a subsequent meeting, the Legal Division defended the sliding scale approach, stressing that the prime consideration should be whether FDIC received commensurate legal services for the fees paid. Thus, the OIG and the Legal Division possess differing views and disagree over the timing and the application of the sliding scale.

The Audit Committee chose to accept the Legal Division's sliding scale approach as adequate and pragmatic for audits already completed which involve missing time sheets. However, the Committee recommended that Legal Division management work towards revising *FDIC's Guide for Outside Counsel* or, if appropriate, the legal services agreements, to better address the issues of missing time sheets; electronic billings; and acceptable, auditable documentation to support billings.

As a result of having brought the problem to the Audit Committee's attention, members of the OIG and Legal Division are now engaged in a joint project to study electronic billing systems. The group's goal is to develop adequate and practical electronic billing standards for outside counsel consistent with certain internal control requirements and the capabilities of commercially available time, billing, and accounting systems used by law firms. During the reporting period, the working group made substantial progress to this end.

The second issue that we discussed with the Audit Committee relates to the area of conflicts of interest. Our audit of legal fees paid to the law firm of Hefner, Stark & Marois had noted that FDIC granted a conditional waiver of conflict of interest with respect to all FDIC/RTC matters and two specific non-FDIC cases handled by the firm. The conditional waiver restricted the lead attorney on the two specific non-FDIC cases, and all attorneys and support staff working with him on those matters, from contact with the attorneys and support staff working on FDIC and RTC matters. Violations of the conditional waiver occurred when several attorneys, paralegals and law clerks who worked on one or both of the two-named matters also worked on FDIC and/or RTC matters. Subsequently, the joint FDIC/RTC Outside Counsel Conflicts Committee reviewed the conflict of interest and decided to reprimand the firm for its violation of the conditional waiver.

The OIG's position was that FDIC should disallow the professional fees charged for these "walled off" attorneys. The Legal Division responded that the questioned costs would be allowed, noting that there was no evidence that the violation caused damage to the interests of FDIC. The OIG believed that the reprimand was insufficient, fearing that although the dollar amount was small in this particular instance, law firms may not take the conditional waivers seriously. While the OIG did not find evidence that the problem was systemic, we did believe the issue should be raised as a possible indicator of more wide-spread problems.

In a subsequent Audit Committee meeting, the Legal Division presented its position on the conflicts issue. The General Counsel felt that the determination of the Conflicts Committee had been appropriate, particularly since it appeared work had been performed and services were rendered by the law firm. Following an extended discussion, Audit Committee members noted that it appeared sufficient safeguards and procedures were in place to protect the interests of the FDIC and that the concerns expressed by the OIG and Legal Division related to the appropriateness of the remedy rather than the adequacy of the Legal Division's safeguards. The OIG will continue to monitor the matter of conflicts of interest in all its law firm audits.

With respect to the 29 reports we issued on individual law firm billings, the OIG continues to identify problems with some firm billings. Among the practices the OIG continues to cite are the following: unsupported billings, billing errors, unauthorized markups, inadequate descriptions of services provided, excessive time charges, and inappropriate staffing. A listing of all firms audited during the reporting period along with the associated monetary findings for each is contained in Table 2 of Appendix I.

The OIG is continuing its work in the area of legal services provided to the Corporation. Current work includes 115 legal fee bill audits.